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FEDERAL COMMUNICATIONS COMMISSION
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April 13, 1993

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20054

In the Matter of Simplification of the Depreciation Prescription Process	)))))	CC Docket No. 92-296

REPLY COMMENTS

MCI Telecommunications Corporation ("MCI") hereby submits its reply comments in response to comments filed on March 10, 1993, in the above-captioned proceeding. In its initial comments, MCI argued it would be premature to grant the LECs flexibility in prescribing depreciation rates until the Commission addressed the underlying issue of who should fund the plant whose obsolescence is accelerated by the escalating efforts of the LECs to enter competitive markets. The cost of calculating depreciation under the current method is immaterial; further, only some ill-defined portion of the expense will be saved by simplifying the current depreciation prescription methodology. Though LEC depreciation charges are accorded endogenous retains the greatest degree of oversight and guards best against anti-competitive abuse of the depreciation process.

I. The LECs Have Not Demonstrated that the Proposed Depreciation Calculation Simplification Would Result in Any Meaningful Savings or Other Benefits.

In its comments, MCI challenged the proposition that the LECs' desire for a simplified depreciation prescription methodology is in fact predicated on anticipated cost savings. Many commenting parties also questioned whether there would be any cost savings at all.[2] Other parties echoed MCI's observation that even if maximum savings were achieved, it would be insignificant.[3] This is in part because even if the FCC were to alter its depreciation process, the state regulatory agencies would not necessarily eliminate any of their current requirements, which have historically reflected or paralleled the FCC's methodologies.[4] Further, even if all the states adopted the

[2]New York State Department of Public Service Comments, p. 2 ("[N]o significant cost savings would result from the implementation of any of the four proposed options."); and Missouri Public Service Commission ("PSC") Comments, pp. 1-2 ("We are not convinced that any cost savings derived from elimination of three-way meetings will be in best interests of the regulators (FCC and states), the companies and the ratepayers.").

[3]See, e.g., Idaho Public Utilities Commission ("PUC") Comments, p. 2 ("The $35-$50 million estimated cost is less than three-tenths of one percent of annual depreciation expense."); State Consumer Advocates Comments, p. 10 ("These savings [.04-.05% of revenue] are so small that they would never be reflected in rates to customers. . . ."); and Utah Division of Public Utilities ("DPU"), p. 1 ("The claimed $35-50 million of annual costs to determine depreciation rates is grossly overstated and unsupportable.").

[4]California PUC Comments, p. 2 ("The CPUC. . . is skeptical that any simplification will substantially reduce represcription costs, since. . . a large percentage of these costs results from maintaining accounting and property records necessary for income tax and valuation of the plant for property tax, etc."); and Oregon PUC Comments, p. 2 ("[T]he cost. . . of the current depreciation process is minor, particularly since at least some of it would need to be incurred even if one of the four options is

FCC's simplified plan, certain core analysis would continue to be performed by all carriers for financial, tax,[5] and other purposes. The advocacy of state regulatory bodies for the retention of both the current three-way meetings and LEC Continuing Property Records[6] illustrates this point.

Nor do the LECs offer any evidence that the savings would be significant. In fact, the United States Telephone Association ("USTA") retreats from its initial estimate of \$35-\$50 million[7] and concedes that the savings would more likely be only 47.3% of the lower figure in the range, or \$16.1 million.[8] The estimates for individual LECs range from \$1 million (the cost of the triennial review) to \$2 million,[9] and are in line

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adopted.").

[5]See, e.g., Texas PUC Comments, p. 6. Also, it must be noted that a significant portion of the LECs' depreciation expense is allocated to the intrastate jurisdiction. In New York, for example, 71% of NYNEX's total company depreciation expense is under the jurisdiction of the NYSDPS (NYSDPS Comments, p. 7), suggesting that, given the overwhelming resistance of state regulators to allow depreciation simplification, even were the FCC to adopt simplification rules, the overall cost savings would be minimal since depreciation data generally would be tracked on an unseparated basis.

[6]See, e.g., Missouri PSC Comments, p. 2; California PUC Comments, p. 12; Michigan PSC Staff Comments, p. 5; Oregon PUC Comments, p. 1; NYSDPS Comments, p. 6; and NARUC Comments, pp. 5-7. While three-way meetings certainly could not continue without FCC participation, the state regulators' interest in maintaining them suggests the states would continue to maintain a significant level of scrutiny of LEC depreciation expenses.

[7]NPRM, at para.8.

[8]\$16.1 million represents only one percent of the BOCs' and GTE's 1991 operating expenses.

[9]Pacific Bell and Nevada Bell Comments, p. 2; and Ameritech Comments, p. 5.

with USTA's industry-wide calculation. Clearly, this level of cost savings is not "worth the loss in actual data analysis."[10]

II. Adoption of the Price Cap Carrier Option Would Provide LECs the Means to Fund Infrastructure Development Necessary for Competitive Service Offerings.

Though the LECs may attempt to hide their true motivation for seeking depreciation reform in the sheep's clothing of administrative and cost savings, it is readily apparent that they are driven by their ambition to pursue competitive ventures. Bell Atlantic, for example, identifies the development of competition as one of two of the "most critical variables affecting the remaining lives of a carrier's existing assets."[11] United Telephone -- Southeast, Inc. ("United") even more explicitly explains, "Current depreciation practices are. . . slow to recognize technological and competition driven changes of service lives."[12]Similarly, NYNEX admits that "a chief determinant of asset lives it the company's plans for modernization in response to market and regulatory forces."[13] Even more to the point, Southwestern Bell and GTE acknowl-

[10]PUC of Texas Comments, p. 1.

[11]Bell Atlantic Comments, p. 5.

[12]United Comments, p. 3.

[13]NYNEX Comments, pp. 7-8.

edge that copper plant is the specific network component for which depreciation needs to be accelerated.[14]

It is apparent that the LECs envision the Price Cap Carrier Option as a means of financing their network upgrades to provide competitive services. MCI reaches this conclusion in part because the LECs offer no alternative plan. Several LECs reference the write-offs that both MCI and AT&T endured in order to upgrade their facilities[15] in response to competitive pressures, yet none of the LECs volunteers that its ratepayers should similarly fund deployment of new technologies. Though the LECs complain that they lack the flexibility their potential competitors have to accelerate the depreciation of assets,[16] this failure to acknowledge the only option available to their potential

[14]Southwestern Bell Comments, p. 5, citing Wilson, Carol, *The Three Best Things LECs Can Do in 1993*, Telephony, January 25, 1993, at p. 20 ("the copper network. . . is not likely to carry LECs into the future."); and GTE Comments, p. 7, citing Vanston, Lawrence K., *New Telecom Services and the Public Network*, NEW TELECOM QUARTERLY 1Q93, at 18-22 ("an exchange carrier must deploy a broadband network by 2015 and in some markets by 2010.").

[15]BellSouth Comments, p. 15; and Pacific Bell and Nevada Bell Comments, p. 12.

[16]USTA Comments, p. 4 ("Competitors of the fully subject carriers are not restrained by the Commission's depreciation procedures."); BellSouth Comments, p. 18 ("Non-dominant interexchange carriers' depreciation rates are not regulated by the Commission"); and SNET Comments, pp. 6-7 ("Competitive service providers are altogether free from the capital recovery regulations that are placed on the LECs.").

Thoughout their comments, the LECs frequently reference the unamortized depreciation reserves that they attribute to inaccurate Commission prescription of their depreciation expenses. (See, e.g., Bell Atlantic Comments, p. 4.) Although a likely outcome of Commission adoption the Price Cap Carrier Option is accelerated LEC depreciation, the LECs have provided no meaningful evidence that such a course of action is even necessary. LECs can instead, file for waiver of the current rules to write off under-depreciation plant -- like their competitive counterparts have done. Alternatively, LECs can use earnings available in the "No Share" zone to reduce plant that is no longer useful for their purposes. MCI continues to contend that it is the LEC shareholders who competitors for dealing with a similar concern (i.e., network obsolescence), reveals that the LECs are not yet ready to wean themselves from their monopolistic safe haven. In an era of emerging competition, however, the LECs cannot have it both ways. Any flexibility the Commission grants must be coupled with a commensurate reduction in monopoly-based financial guarantees. As the California PUC notes, "[i]f any of the proposed simplification options are adopted and utilized, stockholders rather than ratepayers should be responsible for any depreciation reserve problems which subsequently develop with respect to the plant categories for which such option is chosen."[17] Similarly, NYSDPS contends that "depreciation reserve imbalances, stranded investments, etc. resulting from the selections made by the carrier will be borne entirely by the company and not by ratepayers."[18]

As MCI stated in its comments, it has no objection to funding those functions of the network it needs and uses.[19] As a monopoly ratepayer, however, it resists being who should (not "who will") fund these capital investments. MCI contends -- and commenting parties concur -- that the Price Cap Carrier Option that the LECs so strongly advocate lacks adequate safeguards and provides LECs with a mechanism that may force monopoly ratepayers to subsidize LEC competitive enterprises.

III. The Price Cap Carrier Option Inappropriately Substitutes Flexibility for Safeguards.

The LECs are unanimous in their support of depreciation simplification that could provide them the opportunity to manipulate the Price Cap sharing mechanism and lower adjustment formula to their benefit while essentially being freed from all meaningful oversight of the depreciation prescription process.

In general, the LECs offer monitoring safeguards and accounting methods as guarantees that they would be unable to game the Price Cap sharing mechanism.[20] Further, some contend that it would be unnecessary[21] or too cumbersome[22] for them to bother with such efforts. Others rely on competition[23] -- which has not yet developed in the relevant markets -- to deter sharing manipulation; and some simply suggest they would not do it.[24]

While MCI appreciates these carriers' good intentions, it has never believed that accounting safeguards adequately protect the competing interests of the parties involved. Nor is it satisfied that verbal guarantees can be relied upon in markets where competition is emerging, and one competitor is dependent upon another for access to a monopoly service. The simple fact is that the Price Cap Carrier Option provides the opportunity[25] for manipulation, and LECs have the incentive[26] to engage in such manipulation. Since even Pacific Bell and Nevada Bell recognize that the opportunity exists: "higher depreciation expenses can lead to lower earnings for carriers. . . ,"[27] it is incumbent upon the Commission to adopt safeguards to prevent dependent competitors from funding LEC competitive ventures.

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[24]NYNEX Comments, p. 9 (A "LEC [who was near a level of earnings to engage in sharing] would not in effect take money from the shareholder to avoid that sharing.").

[25]NARUC Comments, p. 12 ("However, under the FCC's present price cap scheme, which clearly retains earnings regulation, there is a strong incentive to either hold down depreciation expenses if the company is earning below its authorized return, or increase them if the company is earning above or near the upper end of its authorized return.") Emphasis supplied; and Oregon PUC Comments, p. 3 (The Price Cap Option "would

MCI does not suggest that LECs would, as a rule, incorporate manipulation of the sharing mechanism into their planning processes. As long as the opportunity to abuse this mechanism exists, however, it is possible in times of unexpected earnings results, that the LECs could turn to this mechanism to make some much-needed adjustment to their earnings. Many commenting parties agree that since the Price Cap plan incorporates a sharing mechanism, the Price Cap Carrier Option should not be adopted.[28]

Finally, commentors agree that the Price Cap Carrier Option is inappropriate because it provides the LECs with too much flexibility in calculating their own depreciation rates,[29] while removing any meaningful Commission or third party oversight.[30] Relaxed depreciation procedures should not be adopted because competition in the

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[28]See, e.g., California PUC Comments, p. 9 ("[I]t would only be appropriate to employ [the Price Cap Carrier] option in a regulatory environment which has no earnings oversight."); and Virginia State Corporation Commission Staff ("VSCCS") Comments, p. 2 (" [Since t]he FCC's LEC price cap scheme. . . retains earnings oversight. . . an incentive remains to control depreciation expenses to avoid an overearnings condition where refunds or rate reductions would result.").

[29]VSCCS Comments, p. 2 (The Price Cap Carrier Option "would fully deregulate depreciation prescription for price cap companies by allowing them to calculate their own depreciation rates.")

[30]SCA Comments, pp. 21-22 ("Without the requirement that carriers supply certain fundamental depreciation information, the FCC would not have a record on which to base its depreciation rates decisions."); Utah Division of Public Utilities Comments, p. 3 ("Without any information, it would be very difficult for the states, or any other interested party, to file meaningful comments."); and PSC of Wisconsin Comments, p. 7 ("To allow telephone carriers to choose any depreciation rate without providing supporting data would, over time, remove the ability of commissions and customers to question the validity of the depreciation allocation process.").

local exchange market has not yet developed to a degree that could effectively constrain potential anti-competitive behaviors of the LECs.[31]

IV. Conclusion

For the foregoing reasons, MCI urges the Commission not to adopt a simplified mechanism for calculating LEC depreciation, but to retain the current procedures. If it nonetheless pursues depreciation reform, it should adopt Option 1, the Basic Range Option, that provides for the most competitive safeguards.

Respectfully submitted,

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April 13, 1993

[31]NYSDPS Comments, pp. 2-3 (Regulatory oversight of the LECs should not be reduced "before the competitive market has developed enough to adequately protect ratepayers. . . . As long as there are captive ratepayers of a monopoly, regulators must provide strict oversight. In fact, where a company operates in both a competitive and regulated environment, regulatory review is even more important in order to prevent inappropriate subsidies of competitive services by monopoly ratepayers."). Emphasis Added.

STATEMENT OF VERIFICATION

I have read the foregoing and, to the best of my knowledge, information, and belief, there is good ground to support it, and it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on April 13, 1993.

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CERTIFICATE OF SERVICE

I, Carolyn McTaw, do hereby certify that on this 13th day of April, 1993, copies of the foregoing MCI petition for reconsideration CC Docket 92-296 were served by first-class mail, postage prepaid, unless otherwise indicated to the parties on the attached list.

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